



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

October 11, 2006

H.R. 5122 **John Warner National Defense Authorization Act for Fiscal Year 2007**

As cleared by the Congress on September 30, 2006

SUMMARY

H.R. 5122 would authorize the appropriation of about \$526 billion for fiscal year 2007. Those discretionary costs of implementing the act are not discussed here; this cost estimate addresses only the effects H.R. 5122 would have on direct spending and revenues.¹

H.R. 5122 contains provisions that would both increase and decrease outlays from direct spending, including provisions affecting military retirement, health care for military retirees and reservists, and housing for active-duty servicemembers and their families. H.R. 5122 also would allow the Department of Defense (DoD) to increase sales of certain materials from the strategic stockpile and require the transfer of unobligated balances from the stockpile fund. Overall, CBO estimates that H.R. 5122 would increase direct spending by \$150 million in 2007, \$215 million over the 2007-2011 period, and \$403 million over the 2007-2016 period.

In addition, H.R. 5122 would reduce federal revenues, primarily by modifying the eligibility requirements for the TRICARE Reserve Select program. CBO estimates that H.R. 5122 would decrease revenues by \$3 million over the 2007-2011 period and by \$22 million over the 2007-2016 period.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

CBO's estimate of the budgetary effects of provisions that affect direct spending (including proceeds from asset sales) and revenues is shown in Table 1. The effects of direct spending

1. For details on discretionary costs associated with earlier versions of the act, see the cost estimate transmitted on May 9, 2006, for H.R. 5122, as reported by the House Committee on Armed Services; and the cost estimate transmitted on June 9, 2006, for S. 2766 (an identically titled bill), as reported by the Senate Committee on Armed Services. (Both of those estimates are available at www.cbo.gov.) Those earlier versions of the legislation would have authorized a somewhat lower amount for 2007 appropriations.

fall primarily within budget functions 050 (national defense), 550 (health), and 600 (income security).

TABLE 1. SUMMARY OF H.R. 5122'S EFFECTS ON DIRECT SPENDING AND REVENUES

	By Fiscal Year, in Millions of Dollars										2007-2016
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Changes in outlays ^a	150	-15	16	31	31	29	33	39	43	49	403
Changes in revenues	*	*	*	-1	-2	-3	-3	-4	-4	-4	22

NOTE: * = Reduction in revenues of less than \$500,000.

a. Five- and 10-year costs in the text may differ slightly from the sum of the annual costs listed here because of rounding.

BASIS OF ESTIMATE

H.R. 5122 contains provisions that would both increase and decrease outlays from direct spending, including asset sales. In total, CBO estimates that the act would increase direct spending by \$150 million in 2007, \$215 million over the 2007-2011 period, and \$403 million over the 2007-2016 period (see Table 2 for details). The act would also decrease revenues by about \$3 million over the 2007-2011 period and by \$22 million over the 2007-2016 period, CBO estimates.

Direct Spending

The primary effects of H.R. 5122 on direct spending stem from provisions related to TRICARE pharmacy copayments and to an increased multiplier for military retirement annuities. Together, those two provisions account for \$383 million of the estimated 10-year cost of \$403 million.

Prohibiting Copayments and Transferring Funds. Section 708 would temporarily prohibit DoD from increasing copayments for prescription drugs and require the Secretary to transfer unobligated balances to the TRICARE for Life trust fund. CBO estimates that enacting this section would increase costs by \$186 million in 2007. (Because the prohibition applies to only one year, there would be no impact after 2007.)

TABLE 2. ESTIMATED IMPACT OF H.R. 5122 ON DIRECT SPENDING AND REVENUES

	By Fiscal Year, in Millions of Dollars									
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CHANGES IN DIRECT SPENDING ^a										
TRICARE Pharmacy Copayments										
Estimated Budget Authority	186	0	0	0	0	0	0	0	0	0
Estimated Outlays	186	0	0	0	0	0	0	0	0	0
Transfer from the National Defense Stockpile Transaction Fund										
Estimated Budget Authority	-186	0	0	0	0	0	0	0	0	0
Estimated Outlays	0	0	0	0	0	0	0	0	0	0
Increased Multiplier for Retirement Annuities										
Estimated Budget Authority	2	6	10	13	17	21	25	30	34	39
Estimated Outlays	2	6	10	13	17	21	25	30	34	39
National Defense Stockpile										
Estimated Budget Authority	-38	-20	0	0	0	0	0	0	0	0
Estimated Outlays	-38	-20	0	0	0	0	0	0	0	0
Maximum Term of Leases for Overseas Facilities										
Estimated Budget Authority	1	2	5	5	5	5	5	5	5	5
Estimated Outlays	*	1	3	5	5	5	5	5	5	5
Pilot Projects for Military Housing										
Estimated Budget Authority	0	0	30	0	0	0	0	0	0	0
Estimated Outlays	0	0	4	14	9	2	1	0	0	0
TRICARE Reserve Select										
Estimated Budget Authority	0	-3	-4	-4	-4	-4	-4	-4	-5	-5
Estimated Outlays	0	-3	-4	-4	-4	-4	-4	-4	-5	-5
Retirement Annuities for Senior Officers										
Estimated Budget Authority	*	*	1	1	2	3	4	5	6	7
Estimated Outlays	*	*	1	1	2	3	4	5	6	7
Debt Forgiveness										
Estimated Budget Authority	*	1	1	1	1	1	1	2	2	2
Estimated Outlays	*	1	1	1	1	1	1	2	2	2
SBP for Dependent Children										
Estimated Budget Authority	*	*	1	1	1	1	1	1	1	1
Estimated Outlays	*	*	1	1	1	1	1	1	1	1
Total Changes in Direct Spending										
Estimated Budget Authority	-35	-14	44	17	22	27	32	39	43	49
Estimated Outlays	150	-15	16	31	31	29	33	39	43	49

(Continued)

TABLE 2. CONTINUED

	By Fiscal Year, in Millions of Dollars									
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CHANGES IN REVENUES										
Thrift Savings Plan	*	*	*	*	*	*	*	*	*	*
TRICARE for Reservists	<u>0</u>	<u>0</u>	<u>0</u>	<u>-1</u>	<u>-2</u>	<u>-3</u>	<u>-3</u>	<u>-4</u>	<u>-4</u>	<u>-4</u>
Total Changes in Revenues	*	*	*	-1	-2	-3	-3	-4	-4	-4

NOTES: SBP = Survivor Benefit Plan.

* = between -\$500,000 and \$500,000.

a. Five- and 10-year costs in the text may differ slightly from the sum of the annual costs listed here because of rounding.

TRICARE Pharmacy Copayments. Section 708 would prohibit DoD from changing the cost-sharing amounts that beneficiaries will pay for pharmaceutical drugs in 2007. All TRICARE participants can have prescriptions filled in one of three ways: through the mail-order program (TMOP), at military treatment facilities (MTFs), or at retail pharmacies. Under current DoD plans, beneficiaries will be charged copayments of \$5 for generic drugs and \$15 for brand-name drugs at retail pharmacies and \$9 for brand-name drugs obtained through the TMOP. There will be no copayment for generic drugs through the TMOP, nor for drugs obtained at MTFs. Section 708 would require that the current copayments of \$3 for generic drugs and \$9 for brand-name drugs obtained at retail pharmacies be maintained until September 30, 2007. Those copayment amounts apply to active-duty dependents and all retirees and their dependents. Retirees and their dependents age 65 and older are covered under TRICARE for Life, which is classified in the federal budget as a mandatory (i.e., direct spending) program.

CBO estimates that prohibiting the increase in copayments for TRICARE for Life beneficiaries filling prescriptions at retail pharmacies would increase direct spending by about \$102 million in 2007.

CBO also estimates costs to the government because some beneficiaries would keep their prescriptions at retail pharmacies instead of filling them at MTFs or through TMOP, which are cheaper for DoD, or not getting them filled at all. CBO estimates that in 2007 about 800,000 prescriptions would not have been filled under DoD copayment plans and almost 3 million prescriptions would have transferred from retail pharmacies to MTFs or TMOP. Maintaining these prescriptions at retail pharmacies would cost about \$84 million in 2007.

Transfer from the National Defense Stockpile Transaction Fund. Section 708 also would require the Secretary to transfer \$186 million from the unobligated balances of the National Defense Stockpile Transaction Fund to the DoD trust fund that pays for the health care of TRICARE for Life beneficiaries. This transaction would decrease budget authority by \$186 million in 2007, resulting in no net change in budget authority for section 708 as a whole. However, the transfer would not affect federal outlays because CBO estimates that those balances would not be spent over the 2007-2016 period under current law. (Thus, section 708 would have a net cost of \$186 million.)

Increased Multiplier for Retirement Annuities. The monthly retirement benefit for members of the uniformed services equals the members' pay base times a multiplier, which is based on total years of service, up to a maximum of 30 years. Section 642 would eliminate the 30-year cap, allowing retirement annuities to be based on the total number of years served. The resulting increase in direct spending initially would be small because only newly retired individuals would be eligible; however, as additional cohorts joined them each year, additional spending due to this provision would grow. An average of nearly 400 individuals each year would become entitled to increased annuities based on more than 30 years of service. As a result, CBO estimates that this provision would increase direct spending for military retirement by \$2 million in 2007, \$48 million over the 2007-2011 period, and \$197 million over the 2007-2016 period.

National Defense Stockpile. Section 3302 would increase by \$16 million the target contained in the National Defense Authorization Act for Fiscal Year 1999 (Public Law 105-261; later revised by Public Laws 106-398, 107-107, 108-375, and 109-163) for sales from the National Defense Stockpile through 2014. CBO estimates that there would be sufficient quantities of materials in the stockpile to achieve additional sales receipts of \$16 million in 2007.

Section 3302 also would extend by two years the period to sell materials from the National Defense Stockpile as previously authorized in the National Defense Authorization Act for Fiscal Year 1997 (Public Law 104-201; later revised by Public Laws 106-65 and 107-107). The authority to sell those materials expired on September 30, 2006, and CBO estimates that, by extending the sales through 2008, an additional \$2 million in receipts could be achieved in 2007.

Section 3302 also would extend by two years the period to sell materials from the National Defense Stockpile as previously authorized in the National Defense Authorization Act for Fiscal Year 1998 (Public Law 105-85; later revised by Public Law 107-107). The authority to sell those materials expired on September 30, 2006, and CBO estimates that about 3 million pounds of cobalt materials would be available for sale in 2007 and 2008. CBO

estimates that, by extending the sales through 2008, an additional \$20 million in receipts could be achieved in each of 2007 and 2008.

Maximum Term of Leases for Overseas Facilities. DoD is authorized to lease overseas facilities other than family housing units for a maximum term of five years. Section 2824 would extend that maximum lease term to 10 years.

According to information provided by DoD, the facilities that it leases overseas usually require costly modifications to meet government requirements. The lessor amortizes the cost of those modifications over the term of the lease. Because DoD becomes obligated to pay the full cost of those modifications when it enters those leases, the costs should be recorded in the budget in the year the lease is signed, rather than amortized over the lease term. The Office of Management and Budget permits DoD to incur those obligations if it has appropriations sufficient to cover the cost of the lease in the first year, thus allowing the department to incur that obligation in advance of appropriations. CBO believes that this practice is inconsistent with governmentwide accounting principles.

Because DoD could spread the cost of the initial modifications over a larger number of years, extending the maximum lease period would result in smaller annual lease payments. Therefore, CBO expects that DoD will enter into more leases if the maximum lease term is increased from five to 10 years. CBO estimates that such spending on overseas leases would not increase significantly in 2007 but would cost \$14 million over the 2007-2011 period and \$39 million over the 2007-2016 period.

Pilot Projects for Military Housing. Section 2812 would expand the Navy's authority to use third-party financing to acquire housing for certain military personnel by extending the expiration of that authority from September 30, 2007, to September 30, 2009.

CBO believes that acquiring housing for military personnel in that manner is a governmental activity that uses a private-sector financial intermediary to serve as an instrument of the federal government. In CBO's view, ventures that borrow funds to construct or refurbish military housing should be treated as governmental and their investments should be recorded up front, as borrowing authority—a form of budget authority. Amounts expended by these public-private ventures should be recorded in the budget as outlays at the time they occur.

Title 10, United States Code, section 2881a provides authority for the Navy to pursue three pilot projects to acquire housing for sailors. Based on information from the Navy, CBO estimates that only two housing projects will be acquired before the current expiration date

of September 30, 2007. CBO estimates that extending the deadline until the end of fiscal year 2009 would allow the Navy to acquire one more housing project than it could acquire under current law. CBO estimates that the Navy would acquire that additional project in 2009.

Based on information from the Navy, CBO estimates that this additional construction activity would have no cost in 2007 or 2008, but would increase outlays by \$27 million over the 2009-2011 period and by \$30 million over the 2009-2016 period.

TRICARE Reserve Select. Under current law, reservists who receive unemployment compensation can participate in TRICARE Reserve Select (the DoD insurance program offered to members of the Selected Reserve) by paying premiums that are lower than those paid by many other reservists. Section 706 would allow all reservists to enroll in TRICARE Reserve Select and pay the same premium regardless of unemployment status, beginning in 2008. Because section 706 would remove the direct link between receiving unemployment compensation and being eligible to participate in TRICARE Reserve Select at low premiums, CBO expects that some reservists would collect unemployment insurance for a shorter period. CBO estimates that enacting section 706 would reduce the average benefit period for reservists by about one week at an average savings of about \$275 per person in 2008. Based on CBO's projections of national unemployment trends, CBO estimates that about 13,000 unemployed reservists will use TRICARE Reserve Select in 2008 and beyond. Thus, CBO estimates that, under section 706, spending for unemployment compensation would decrease by \$15 million over the 2008-2011 period and \$37 million over the 2008-2016 period.

Retirement Annuities for Senior Officers. Basic pay for certain senior officers is set below that listed in the military pay table because it is limited to an amount equal to or less than Level II of the Executive Schedule (changed from Level III by section 602 of this act). Because retirement annuities are computed based on basic pay received before retirement, that limitation results in reduced annuities for the affected officers. Section 641 would remove that restriction for the purposes of computing retirement annuities, resulting in higher annuities for affected officers. Taking into account the interaction of sections 641 and 642 (mentioned earlier), CBO estimates that this provision would increase direct spending for military retirement by less than \$500,000 in 2007, \$5 million over the 2007-2011 period, and \$28 million over the 2007-2016 period.

Debt Forgiveness. Section 673 would enhance and extend the authority of the service secretaries to forgive debts incurred by officers and members of the National Guard and Reserve serving on active duty. Prior to 2006, debt forgiveness could be offered to enlisted members only. The enhancement of this authority to include officers and reserve component

members was enacted as part of the National Defense Authorization Act for Fiscal Year 2006 (Public Law 109-163), but that act made those changes effective only through December 31, 2007. Section 673 would extend that additional authority indefinitely and also would enhance current authority by giving the service secretaries greater flexibility to forgive the debts of members who have since left active duty. Because some of those debts would have been paid to the Treasury, the extended and enhanced authorities in section 673 would result in a loss of offsetting receipts.

Based on data from the Department of Defense, CBO estimates an additional 1,500 servicemembers would have debts forgiven each year under this proposal and that the average amount of each debt forgiven would be about \$1,000. CBO estimates the amount that would have been repaid to the Treasury to be about \$1 million a year. Thus, the increase in direct spending under section 673 would total about \$13 million over the 2007-2016 period.

SBP for Dependent Children. Under current law, surviving spouses of servicemembers who die after November 23, 2003, have the option of directing payment of Survivor Benefit Plan (SBP) benefits to the member's dependent children rather than themselves. Section 644 would move that date back by over two years, to October 7, 2001. Because SBP payments to spouses are reduced by the amount of Dependency and Indemnity Compensation (DIC) payments while those to dependent children are not, CBO believes that many of the newly eligible survivors would take advantage of this authority. CBO estimates that this provision would increase direct spending for retirement annuities by less than \$500,000 in 2007, \$3 million over the 2007-2011 period, and \$5 million over the 2007-2016 period.

Other Provisions. The following provisions would have an insignificant budgetary impact on direct spending:

- Section 353 would allow the Army to sell demilitarized and recycled munitions and retain the proceeds to fund the reclamation, recycling, and reuse of conventional military munitions.
- Section 354 would authorize the Army to recover firearms and firearm-related parts and supplies granted to foreign nations under the Foreign Assistance Act of 1961 for the purpose of transferring such items to the Corporation for the Promotion of Rifle Practice and Firearms Safety. This section would require the corporation to reimburse the Army for the cost of recovery of such items and would allow the Army to retain and spend any such reimbursements.

- Section 505 would allow certain retirement-eligible chief warrant officers who have failed to be selected for promotion twice to be allowed to continue on active duty at the discretion of the service secretaries.
- Section 523 would allow National Guard members who served on state active duty in support of a federal declaration of emergency in specified counties in the state of New Jersey, between September 11, 2001, and October 1, 2002, to apply that time served toward their federal military retirement.
- Section 599 would allow certain members of the Marine Corps to retire at higher grades if they were appointed to those grades in the course of their service in the Marine Band and Marine Drum and Bugle Corps.
- Section 643 would allow retirees to choose a replacement beneficiary under the insurable interest option of the Survivor Benefit Plan in cases where the retiree outlives the initial beneficiary.
- Section 705 would require the Secretary of Defense to conduct a demonstration project in which select over-the-counter drugs are provided to beneficiaries instead of prescription drugs.
- Section 831 would extend by one year DoD's authority to settle financial accounts from contracts that were executed prior to September 30, 1996, and that have unreconciled balances of less than \$100,000.
- Section 904 would expand the authority of DoD's Regional Centers for Security Studies to accept contributions to defray the cost of participation of foreign nationals at those centers.
- Section 912 would extend a pilot program that allows DoD to provide satellite tracking services to non-U.S. government entities. Under this program DoD is allowed to charge fees to cover the cost of providing such services.
- Section 933 would allow the National Security Agency (NSA) to collect fees to offset cost of evaluating and certifying information technology products under the National Information Security Program. Since the NSA would be allowed to retain and spend such fees, this section would have no net budgetary impact.
- Section 1051 would allow DoD to collect fees from individuals attending DoD conferences in amounts necessary to offset the cost of conducting such conferences.

Revenues

H.R. 5122 contains two provisions that CBO estimates would decrease revenues by \$3 million over the 2007-2011 period and by \$22 million over the 2007-2016 period.

TRICARE Reserve Select. Unemployment tax revenues collected by the states are recorded as income to the federal government's Unemployment Trust Fund. As discussed above under the heading "TRICARE Reserve Select," CBO estimates that enacting section 706 would lead to fewer outlays from the government's Unemployment Trust Fund. Because states attempt to maintain sufficient balances in their unemployment insurance accounts while keeping tax rates as low as possible, changes in outlays for benefits translate into changes in revenues. Thus, CBO estimates that under section 706, revenues would decline by \$3 million over the 2010-2011 period and \$21 million over the 2010-2016 period.

Thrift Savings Plan. Section 608 would extend through December 31, 2008, a pilot program that allows the Army to offer matching contributions to the Thrift Savings Plan (TSP) for new enlistees in critical specialties. CBO expects that providing matching contributions encourages new enlistees to increase their participation in the TSP. Because income taxes are deferred on TSP contributions, the anticipated increase in contributions initially results in lower income-tax revenue. Additionally, the earnings would be taxable if the savings were invested in taxable accounts. Thus, the lack of taxation on the earnings reduces income-tax revenue.

For this estimate, CBO assumes that, under the pilot program, the Army would offer the opportunity to obtain matching contributions to approximately 5,000 first-time enlistees per year or about 6.5 percent of the enlistees expected through December 31, 2008. Because the size of the pilot program would be small, CBO estimates that the revenue losses would be less than \$500,000 a year. The projected revenue loss of the pilot program would total about \$1 million over the 2007-2016 period.

PREVIOUS CBO ESTIMATES

On May 9, 2006, CBO transmitted a cost estimate for H.R. 5122 as reported by the House Committee on Armed Services on May 5, 2006. CBO estimated that the earlier version of H.R. 5122 would have decreased direct spending by \$11 million over the 2007-2011 period but have no net effect on such spending over the 2007-2016 period. In addition, that version of H.R. 5122 would have reduced federal revenues by an estimated \$3 million over the 2007-2011 period and by \$21 million through 2016.

On June 9, 2006, CBO transmitted a cost estimate for S. 2766, the National Defense Authorization Act for Fiscal year 2007, as reported by the Senate Committee on Armed Services on May 9, 2006. CBO estimated that S. 2766 would have increased direct spending by \$1.4 billion over the 2007-2011 period and by \$2.0 billion over the 2007-2016 period. In addition, the legislation would have decreased federal revenues by an estimated \$1 million over the 2007-2016 period.

Many provisions in H.R. 5122 are identical to or very similar to provisions in those earlier versions of the legislation. However, H.R. 5122, as cleared by the Congress, contains several provisions that were not in either of the earlier versions. In particular, the current version of H.R. 5122 contains several provisions that would increase military retirement and survivor benefits. CBO estimates those provisions would increase direct spending by \$2 million in 2007, \$56 million over the 2007-2011 period, and \$230 million over the 2007-2016 period.

ESTIMATE PREPARED BY:

Health Programs: Michelle S. Patterson
Military Construction: David Newman
Military Personnel: Matthew Schmit
Operation and Maintenance: Jason Wheelock
Military Retirement Benefits: Mike Waters
Thrift Savings Plan: Barbara Edwards
Stockpile Sales: Raymond J. Hall

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis